



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
N.S.B. CORPORATION)

For Appellant: Linda J. Lester
Attorney at Law

For Respondent: Kathleen M. Morris
Counsel

O P I N I O N

This appeal is made pursuant to section 26075, subdivision (a), of the Revenue and Taxation Code from the action of the Franchise Tax Board in denying the claim of N.S.B. Corporation for refund of franchise tax in the amount of **\$9,098.11** for the income year 1974.

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Appellant was ~~incorporated~~^{1/} under the name of Bernstein's of Long Beach and began doing business in California in 1960. Its primary business activity was the manufacture of Bernstein's salad dressings and sauces. Appellant filed its tax returns on a calendar year basis, using an accrual method of accounting.

On December 12, 1973, appellant's officers and W. R. Grace & Company (hereinafter Grace) entered into an agreement whereby Grace agreed to purchase the assets of Bernstein's of Long Beach. Those assets included manufacturing equipment, vehicles, and a variety of intangibles, such as Bernstein's formulae, recipes, trade names, goodwill and 'customer lists. Pursuant to the agreement of sale, Grace was to pay appellant \$123,921 for the equipment and vehicles and \$200,000 for the intangible assets. The sales contract specifically provided that Bernstein's would transfer title to the assets to Grace at the "closing," which was to take place no later than February 25, 1974. The word "closing" was defined to mean the consummation of the purchase and sale of the assets pursuant to the terms of the agreement. Pending the closing, Bernstein's was to continue in the ordinary course of its business. During that period, Grace's representatives and agents were to have full access during normal business hours to Bernstein's facilities and warehouses, and Bernstein's employees were to furnish Grace with information about business operations. In addition, Grace was to have access to Bernstein's books and records for the purpose of inspecting and auditing the assets. The contract also set forth certain "conditions precedent" which were to be fulfilled by the parties prior to the closing.,

Immediately after the agreement of sale was executed on December 12, 1973, Nalley's, a division of Grace, began active production planning with respect to the Bernstein's product line. Mr. Norris S. Bernstein, president of Bernstein's, was employed by Grace to assist in the transition, and personnel of Nalley's entered the Bernstein's plant and prepared to move the production equipment in December 1973. The sale

^{1/} Appellant changed its name to N.S.B. Corporation in 1974. References to "Bernstein's" in this opinion are to appellant, prior to its name change.

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transaction was processed through an escrow and was finally closed on January 17, 1974, at which time title to the assets passed and Grace paid appellant the amount owed under the agreement of sale.

Upon audit, respondent discovered that appellant had included gain from the sale of Bernstein's assets in its return for the income year 1973. Respondent excluded this gain from appellant's reported income for that year on the ground that the proceeds from the sale were properly **includible** in appellant's income reportable for income year 1974, since the sale was consummated on January 17, 1974. As a result of the adjustments to the years 1973 and 1974, respondent issued a computation of proposed overpayment in the amount of **\$5,025.89** for the income year 1973 and a notice of additional tax proposed to be assessed in the amount of **\$14,124.00** for the income year 1974. Appellant protested this action and the proposed assessment ultimately was affirmed. **Thereafter**, appellant paid the net adjustment of **\$9,098.11** and filed a **claim for refund**. After considering appellant's arguments, respondent denied appellant's refund claim. This timely appeal followed.

The issue for our determination is whether appellant's gain from sale of the assets of Bernstein's of Long Beach accrued as income to appellant in 1973, as appellant contends, or in 1974, as respondent has determined.

Section 24651 of the Revenue and Taxation Code provides that income shall be computed "under the method of accounting on the basis of which the taxpayer regularly computes its income in keeping its books." As was indicated earlier, appellant maintains its records on an accrual method, calendar year basis. It is elementary that where a taxpayer keeps its books on an accrual basis, it is the right to receive and not the actual receipt of such income that determines the year in which it is **includible** in gross income. (Spring City Foundry Co. v. Commissioner, 292 U.S. 182 [78 L.Ed. 1200] (1934); Appeal of Dant Investment Corporation, Cal. St. Bd. of Equal., March 2, 1977.) In the case of gains from the sale of property, the accrual basis taxpayer realizes gain when a sale is completed and the right to receive payment becomes unqualified because the buyer is unconditionally liable to pay the purchase price. (Lucas v. North Texas Lumber Co., 281 U.S. 11 [74 L.Ed. 668] (1930); Commissioner v. Union Pac. R. Co., 86

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F.2d 637 (2d Cir. 1936).) For tax purposes, a completed or closed transaction results from a contract of **sale** which is absolute and unconditional on the part of the seller to deliver title to the buyer upon payment of the consideration, and by which the purchaser secures immediate possession and exercises all the rights of ownership. (Commissioner v. Union Pac. R. Co., supra.) A **delay** in actual payment does not **prevent** the earlier accrual of income, as long as the contract gives the seller the unqualified right to receive the purchase price. (See Consolidated Gas & Equipment Co. of America, 35 T.C. 67.5 (1961).)

Appellant argues that its gain from sale of the **Bernstein's** assets accrued in 1973, the year the contract of sale was executed, because by the end of that year it had performed its side of the contract and had therefore acquired the right to receive the purchase price. Appellant states that the conditions set forth in the contract had been substantially **performed** by the end of 1973, and the escrow arrangement was merely 'a security device. It contends that in 1973 Grace's personnel actually entered the Bernstein's premises and conducted themselves in a way consistent with ownership. Under these circumstances, appellant argues, the transaction should be treated for tax purposes as a completed sale in 1973, even though the paper work was not completed nor payment received until 1974.

Appellant herein is defeated by the terms of its own **contract**. In that agreement, frequent reference is made to the fact that the sale and purchase of Bernstein's assets was to be consummated at the "closing." Only then was appellant obligated to convey title to the assets, and only then was Grace required to tender the purchase price. As of the end of 1973, some of the conditions set forth in the contract had not **yet been** fulfilled. Although Grace's representatives apparently did have reasonable access to the Bernstein's plant and records prior to the end of 1973, the contract of sale provided that such access, pending the closing, **was** not totally unrestricted. Since Bernstein's was to continue its normal business operations during the period prior to the closing, Grace obviously did not **assume an** immediate possession of the assets, **nor did** it exercise all rights of ownership at that time. Most importantly, until the closing, appellant had no unconditional **right** to receive the sale proceeds.

Based upon the foregoing, we agree with respondent that the gain realized by appellant from its sale of the business assets of Bernstein's of Long Beach did not accrue as income to appellant until January 17, 1974, when title to the assets was transferred by appellant, the purchase price was paid by Grace, and the escrow was closed. It follows, therefore, that appellant was required to include the gain in its income for the income year 1974, rather than the preceding year.

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

Done at Sacramento, California, this 9th day
of December, 1980, by the State Board of Equalization,
with **Members Nevins, Bennett, Reilly and Dronenburg** present.

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